

Guidelines for Preparing Indirect Cost Rate Proposals

These guidelines include information related to:

- A. Basic Steps
- B. Indirect Cost Allocation Bases
- C. Indirect Cost Rate Proposal Documentation
- D. Indirect Cost Proposal – Review Procedures
- E. Administration Limits and Indirect Cost Claims

A. Basic Steps

Prior to the preparation of an indirect cost rate proposal and supporting documentation, the cost principles established by OMB Circular A-122 for grantees or the Federal Acquisition Regulations (Part 31) should be thoroughly reviewed. The entity will then be ready to prepare an indirect cost rate proposal based on the following steps:

1. Organization Review

- Obtain organization chart(s) and any information or material explaining the various services and/or functions for each unit.
- If no organizational chart(s) formally exist, prepare a "roughed-out" chart as well as the description of the various services performed by each unit shown on the chart.
- Determine which units are indirect (administrative) functions of the organization.
- Determine the services that are allowable and allocable to Federal grants and Contracts, under OMB Circular A-122, and FAR Part 31.

2. Review Federal and Non-Federal Funding

- Review the "Federal and Non-Federal Outlays" to determine programs being funded; verify with the appropriate staff.
- Prepare a list of all funded programs in detail as to the amount or percent of reimbursement of direct and indirect cost and any restrictions or references to statutes or regulations.
- Determine at what organizational level the various funded programs apply. Illustrate the list of funded programs on a copy of the organization chart.
- Contact the Federal agency which provides the most funds regarding the procedures for the submission, review and approval of indirect cost rates.

3. Review the Accounting Structure

- Obtain a chart of accounts or some accounting listing of the way in which the actual dollars expended can be related to various programs and/or organization structure.
- Reconcile the accounting structure to the organization chart.
- Determine changes to implement an indirect cost rate system of billing.

4. Prepare a Cost Policy Statement

- Develop a written policy that outlines the costs considered as direct, the costs considered to be indirect, and the rationale to support those costs. A model cost policy statement in Appendix II.

5. Prepare an Indirect Cost Proposal

- Determine which method is best for the organization, i.e., direct cost allocation or simplified and whether special indirect cost rates are required. In selecting the appropriate method, the non-profit organization should consider the following:
 - a. Organizational structure
 - b. Level of Federal funding
 - c. Reports generated from their accounting system
 - d. Availability of data on square footage, number of transactions, employees, purchase orders, etc.
 - e. Additional effort and cost required to achieve a greater degree of accuracy.
- Prepare the indirect cost rate proposal following the examples shown in Section III.
- Obtain signed Certificate of Indirect Costs from Executive Director or other designated official (refer to Appendix III).
- Compile all remaining documentation required by the cognizant Federal agency.
- Reconcile the indirect cost rate proposal to the audited financial statements. Any differences need to be explained.

6. Obtain Cognizant Agency Approval

- Present proposal to cognizant agency; note differences if any; document meeting and/or telephone conversations, and approval. Make any agreed upon changes.
- Receive approved/executed rate agreement.

7. Implementation

- If necessary, obtain modification to Federal agreement.
- Prepare claims using the lower of either the approved rate, or the ceiling rate for your grant or contract.
- Maintain documentation for audit purposes.

B. Indirect Cost Rate Allocation Bases

The following allocation bases are examples only for use when indirect costs are allocated to benefiting cost objectives by means of an indirect cost rate.

1. Direct salaries and wages including (or excluding) all fringe benefits.
2. Direct salaries and wages including vacation, holiday, sick pay, and other paid absences but excluding all other fringe benefits.
3. Total direct cost excluding (if applicable) capital expenditures (buildings, individual items of equipment; alterations and renovations), subawards or that portion of each subaward in excess of \$25,000 and flow-through funds.
4. Total direct costs excluding (if applicable) capital expenditures (buildings, individual items of equipment; alterations and renovations); subawards or that portion of each subaward in excess of \$25,000; rental/maintenance of off-site activities; student (enrollee) tuition payments and student support costs (e.g. student aid, stipends, dependency allowances, scholarships, fellowships).
5. Modified total direct costs consisting of salaries and wages, fringe benefits, materials and supplies, services, travel, and subawards up to \$25,000 each or all subawards.

NOTE: The cost of equipment purchases, major renovation or subcontract costs may vary considerably from program to program which causes the indirect cost to be allocated in a disproportionate amount to the benefit derived. Therefore, such costs will be excluded from the base when a total direct cost is being used.

6. For commercial entities, total costs less G&A expenses.

The selection of an appropriate allocation method is based upon the commonality of costs to all cost objectives. In general, a correlation exists between the incurrence of administrative effort with the expenditures for direct labor. In most cases, a direct labor base will produce an equitable distribution of indirect costs. However, where the ratio of direct labor to total direct costs varies significantly from program to program, an "adjusted" total direct cost base should be used in allocating costs to benefiting programs.

C. Indirect Cost Rate Proposal Documentation

The following information is required on an annual basis from non-profit and commercial organizations that claim indirect costs on cost reimbursable contracts or grants with the U.S. Department of Labor.

1. Organization Profile

- a. A chart showing the organizational structure during the period for which the proposal applies, along with a functional statement noting the duties and/or responsibilities of all units that comprise the organization. (Once this is submitted, only revisions need be submitted with subsequent proposals.)
- b. A copy of the financial data [financial statement (certified, if appropriate), budgets, accounting reports, etc.] upon which the rate is based.
- c. A listing of directly awarded grants and contracts by Federal agency, total dollar amount, period of performance, and the indirect cost limitations (if any) applicable to each, such as, ceiling rates or amounts restricted by administrative or statutory regulations.

2. Cost Policy Statement

The purpose of the Cost Policy Statement (CPS) is to establish an unambiguous understanding between a contractor/grantee and the Federal Government as to what costs will be charged directly and what costs will be charged indirectly.

The Division of Cost Determination requires that an up-to-date CPS be reviewed by its Cost Negotiators as part of the cost determination process when the indirect cost rate proposal is negotiated. Therefore, contractor/grantees are required to submit a CPS with their first proposal. Subsequent proposals need only identify changes that are being made to the initial CPS.

If the contractor/grantee is not proposing any changes, the following suggested language should be included in the transmittal letter when a proposal is submitted:

[ABC Non-Profit/Commercial Organization] hereby confirms that no changes to its accounting policies and practices as set forth in its Cost Policy Statement dated [September 13, 1997] have been made.

An example of a CPS is shown in Appendix II.

3. Personnel Costs Worksheet

A sample of a personnel costs worksheet is presented as Exhibit A in Section III. When preparing a Provisional Indirect Cost Proposal, current approved budget figures should be used in the preparation of the personnel costs worksheet. When a Final Indirect Cost Proposal is prepared, actual personnel costs should be used in preparation of this Exhibit. Actual personnel costs should be documented in accordance with OMB Circular A-122, Attachment B, paragraph 7.m. (1) through (4), and the FAR.

4. Allocation of Personnel Worksheet

This document reflects the estimated/actual salary costs for each Federal and Non-Federal cost objective. The percentage of time per position should be spread under the appropriate cost objective, making sure that 100 percent is allocated for each position.

The grantee/contractor must maintain a time distribution system for use by employees whose time is charged to more than one cost objective. Documented payrolls should be maintained supporting whether the salaries and wages were directly or indirectly charged.

An example of an Allocation of Personnel Worksheet is shown in Exhibit B. An example of an acceptable time distribution report is shown in Exhibit B-1.

5. Statement of Employee Benefits

This document should contain the estimated/actual costs of the items in the employee fringe benefit pool. Employee (fringe) benefits should follow the salary of the individual and are a consideration in the determination of the reasonableness of the compensation. Fringe benefits should be accrued in the period incurred, including accrued leave if employees have an irrevocable right to be compensated during employment or upon termination of employment.

Generally, the cost of annual leave is recognized when it is earned by the employee, and holiday and other types of leave are considered a cost to the extent of actual compensation to employees.

An example of a Statement of Employee Benefits is shown in Exhibit C.

6. Statement of Total Costs

This document should contain all line items of costs included in the entities' chart of accounts with applicable columns for direct costs (by cost center), indirect costs, (overhead, G&A, etc.) and unallowable costs (if applicable).

The total costs should reconcile to the entities' financial statements. If the reconciliation is not clear, the entity should provide a separate schedule supporting the difference.

Examples of Statement of Total Costs are shown in Exhibits D of F, as applicable, for the simplified method or direct allocation method, respectively.

7. Statement of Indirect Costs

This document should contain all line items of costs included in the indirect cost "pool(s)", the applicable allocation base(s), and the resulting indirect cost rate(s).

The allocation base should be traceable to the statement of total costs. If it is not clearly traceable, an additional schedule should be provided to supporting the reconciliation.

Examples of Statement of Total Costs are shown in Exhibits E of G, as applicable, for the simplified method or direct allocation method, respectively.

8. Certificate of Indirect Costs

- a. No proposal to establish indirect cost rates shall be acceptable unless such costs have been certified by the non-profit or profit organization. A "Certificate of Indirect Costs" must be signed on behalf of the organization by an individual at a level no lower than executive director or chief financial officer of the organization that submits the proposal.
- b. The required certificate is shown in Appendix III.

D. Indirect Cost Proposal - Review Procedures

Some of the most likely issues to be raised by the DCD cost negotiator during the review of the indirect cost proposal submitted by an organization result from the following procedures used by the cost negotiator. By keeping these procedures in mind when preparing the indirect cost rate proposal, organizations should be able to anticipate the type of issues that may be raised during negotiations. This should help in preparing documentation to justify the approaches taken.

- Determine that the applicable cost principles (stated in the Circulars or the FAR) were followed.
- Review the organization chart for a visual picture of the flow of responsibility, identification of areas of common costs, and the location of those areas in which federally-funded activity exists
- Perform a mathematical verification of the proposal.
- Determine that the proposal reconciles with the supporting audit, official budget or financial statement.
- Review the financial report for any indication of activities which may have been omitted from the indirect cost proposal, i.e., the omission of restricted fund costs or the existence of an affiliated organization receiving supportive service from the parent organization.
- Determine that the cost centers in the indirect cost pool pertain to functions that are supportive of all direct activity.
- Determine that costs that are statutorily unallowable or for reasons of non-allocability have been eliminated from the indirect cost pool.
- Determine whether these unallowable or non-allocable items should be added to the distribution base.
- Determine that "pass-through" funds have been excluded from the base.
- Determine that all personal service costs eliminated from the indirect cost pool have been added to the base.
- Review the analysis of direct costs for the determination of:

- a. Consistency in charging specific items of cost.
- b. The selection of an appropriate base for allocating indirect costs.
- Review the contract/grant budget and payments or contractor/grantee records for a determination of: (if deemed feasible under the circumstances)
 - a. The direct funding of indirect costs.
 - b. Any limitations placed upon the full recovery of indirect costs, i.e. ceiling rates or amounts.
 - c. Total Federal funds involved.
- Check with the appropriate Federal Program Manager for any problems he/she may be aware of relating to the charging of costs.

E. Administration Limits and Indirect Cost Claims

Various DOL funding instruments have statutory or regulatory limitations on the costs of "administration". The costs of administration are those portions of reasonable, necessary and allowable costs associated with the overall **program** management and administration and which are not directly related to the provision of services to participants or otherwise allocable to the **program** cost objectives/categories. These costs can be both personnel and non-personnel and both direct and indirect. Therefore, the statutory or regulatory limitation affects the combined claims for indirect costs and direct administration costs. Generally, direct administration costs differ from indirect charges in that the latter are considered organization-wide costs.

Examples of functions that are classified as direct "administration" are as follows:

- Overall **program** management, program coordination, and office management functions, including the salaries and related costs of the executive director, project director, project evaluator **when directly allocated**.
- Preparing **program** plans, budgets schedules, and related amendments.
- Monitoring of programs, projects, subrecipients and related systems and processes.
- Developing systems and procedures, including management information systems, for assuring compliance with program requirements.
- Preparing reports and other documents related to the **program** requirements.
- Evaluating program results against stated objectives; and
- Performing administration services such as **program specific** payroll, accounting, auditing or legal activities.

Examples of non-labor costs for direct administration include:

- Costs for goods and services required for administration of the **program**, including such goods and services as the rental or purchase of equipment, utilities, office supplies, postage, and rental and maintenance of office space.
- Travel costs incurred for official business in carrying out **program** management and administrative activities.